



Department
of the
Treasury

Internal
Revenue
Service

Publication 517
Cat. No. 15021x

Social Security and Other Information for Members of the Clergy and Religious Workers

For use in preparing
1997 Returns



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Important Change for 1997

Increased self-employed health insurance deduction. The self-employed health insurance deduction increased from 30% to 40% of the cost of the insurance. See *Health insurance costs of self-employed ministers*.

Introduction

Social security and Medicare taxes are collected under two systems. Under the Federal Insurance Contributions Act (FICA), the employee and the employer each pay half of the taxes. Under the Self-Employment Contributions Act (SECA), the self-employed person pays all the taxes. No earnings are subject to both systems.

This publication covers several issues relating to the collection of social security and Medicare taxes from members of the clergy and religious workers, including:

- Which earnings are taxed under FICA and which under SECA,
- How to figure net earnings from self-employment, and
- How a member of the clergy (minister, member of religious order, or Christian Science practitioner) can apply for an exemption from self-employment tax.

This publication also covers certain income tax rules of interest to the clergy.

A comprehensive example with filled-in forms, showing a minister having income that is taxed under FICA and other income that is taxed under SECA, is at the end of this publication.

Note. In this publication the term "church" is generally used in its generic sense and not in reference to any particular religion.

Useful Items

You may want to see:

Publication

- 525** Taxable and Nontaxable Income
- 529** Miscellaneous Deductions
- 533** Self-Employment Tax
- 535** Business Expenses
- 590** Individual Retirement Arrangements (IRAs)(Including SEP-IRAs and SIMPLE IRAs)
- 596** Earned Income Credit

Form (and Instructions)

- SS-8** Determination of Employee Work Status for Purposes of Federal Employment Taxes and Income Tax Withholding
- SS-16** Certificate of Election of Coverage Under the Federal Insurance Contributions Act
- Schedule SE (Form 1040)** Self-Employment Tax
- 1040-ES** Estimated Tax For Individuals
- 1040X** Amended U.S. Individual Income Tax Return
- 4029** Application for Exemption From Social Security and Medicare Taxes and Waiver of Benefits
- 4361** Application for Exemption From Self-Employment Tax for Use by Ministers, Members of Religious Orders and Christian Science Practitioners

Ordering publications and forms. See *How To Get More Information*, near the end of this publication, for information about getting these publications and forms.

Social Security Coverage

The services you perform in the exercise of your ministry are covered by social security and Medicare under SECA. Your earnings for these services are subject to self-employment tax unless one of the following applies.

- 1) You are a member of a religious order who has taken a vow of poverty.
- 2) You request and receive from the Internal Revenue Service (IRS) an exemption from self-employment tax for the services. See *Exemption From Self-Employment (SE) Tax*, later.
- 3) You are subject only to the social security laws of a foreign country under the provisions of a social security agreement between the United States and that country. For more information, see *Binational Social Security (Totalization) Agreements* in Publication 54, *Tax Guide for U.S. Citizens and Resident Aliens Abroad*.

Your earnings that are not from the exercise of your ministry may be subject to social security tax under FICA or SECA according

to the rules that apply to taxpayers in general. See *Qualified Services*, later.

Ministers

If you are a minister of a church, your earnings for the services you perform in your capacity as a minister are subject to self-employment tax unless you have requested and received an exemption. See *Exemption From Self-Employment (SE) Tax*, later. This is true whether you are an employee of your church or a self-employed person under the common law rules. For the specific services covered, see *Qualified Services*, later.

Ministers Defined

Ministers are individuals who are duly ordained, commissioned, or licensed by a religious body constituting a church or church denomination. They are given the authority to conduct religious worship, perform sacerdotal functions, and administer ordinances or sacraments according to the prescribed tenets and practices of that church or denomination.

If a church or denomination ordains some ministers and licenses or commissions others, anyone licensed or commissioned must be able to perform substantially all the religious functions of an ordained minister to be treated as a minister for social security purposes.

Employment Status for Other Tax Purposes

Even though you are considered a self-employed individual in performing your ministerial services for social security tax purposes, you may be considered an employee for income or retirement plan tax purposes. Some of your income may be considered income from self-employment and other income may be considered income from wages.

Common-law employee. Under common law rules, you are considered an employee or a self-employed person depending on all the facts and circumstances. Generally, you are an employee if your employer has the legal right to control both what you do and how you do it, even if you have considerable discretion and freedom of action. For more information about the common-law rules, get Publication 15-A, *Employer's Supplemental Tax Guide*.

If you are employed by a congregation for a salary, you are generally a common-law employee and income from the exercise of your ministry is considered income from wages for income tax purposes. However, amounts received directly from members of the congregation, such as fees for performing marriages, baptisms, or other personal services, are considered income from self-employment.

Example. A church hires and pays you a salary to perform ministerial services subject to its control. Under the common law rules, you are an employee of the church while performing those services.

Form SS-8. If you are not certain whether you are an employee or a self-employed person, you can get a determination from the IRS by filing Form SS-8.

Members of Religious Orders

If you are a member of a religious order who has **not** taken a vow of poverty, your earnings for required services you performed as a member of the order are subject to self-employment tax. This does not apply if you have requested and received an exemption as discussed under *Exemption From Self-Employment (SE) Tax*, later. To see which services are considered required, see *Qualified Services*, later.

Vow of poverty. If you are a member of a religious order who has taken a vow of poverty, you are **exempt** from paying self-employment tax on your earnings for required services you perform as an agent of your church or its agencies. For income tax purposes, the earnings are tax free to you. Your earnings are considered the income of the religious order.

Exception. Even if you have taken a vow of poverty, the services you perform for your church or its agencies may be covered under social security. Your services are covered if your order, or an autonomous subdivision of the order, elects social security coverage for its current and future vow-of-poverty members.

The order or subdivision elects coverage by filing Form SS-16. It can elect coverage for certain vow-of-poverty members for a retroactive period of up to 20 calendar quarters before the quarter in which it files the certificate.

Services performed outside the order. Even if you are a member of a religious order who has taken a vow of poverty and is required to turn over to the order amounts you earn, your earnings are subject to Federal income tax withholding and employment (FICA) tax if you:

- 1) Work for an organization outside your religious community, and
- 2) Perform work that is not required by, or done on behalf of, the order.

In this case, you are considered an employee of that outside organization. You may, however, be able to take a charitable deduction for the amount you turn over to the order. See Publication 526, *Charitable Contributions*.

Lay employees. Lay employees are generally covered by social security. But see *Election to Exclude Employees From FICA Coverage*, later, under *Religious Workers*.

Rulings. Organizations and individuals may request rulings from the IRS on whether they are religious orders, or members of a religious order, for FICA tax, self-employment tax, and federal income tax withholding purposes. To request a ruling, follow the procedures in Revenue Procedure 98-1, which is published in the 1998-1 Internal Revenue Bulletin.

You can read this Revenue Procedure at most IRS offices or purchase a copy of the Bulletin by writing to:

Superintendent of Documents
U.S. Government Printing Office
P.O. Box 371954
Pittsburgh, PA 15250-7954.

Christian Science Practitioners and Readers

Your earnings from services you performed in your profession as a Christian Science practitioner or reader are generally subject to self-employment tax. However, you can request an exemption as discussed under *Exemption From Self-Employment (SE) Tax*, later.

Practitioners. Christian Science practitioners are members in good standing of the Mother Church, The First Church of Christ Scientist, in Boston, Massachusetts, who practice healing according to the teachings of Christian Science. Christian Science practitioners are specifically exempted from licensing by state laws.

Some Christian Science practitioners also are Christian Science teachers or lecturers. Income from teaching or lecturing is considered the same as income from their work as practitioners.

Readers. Christian Science readers are considered the same as ordained, commissioned, or licensed ministers.

Religious Workers (Employees)

If you are a religious worker (an employee) and are not in one of the classes already discussed, your wages are generally subject to social security and Medicare tax (FICA) and not to self-employment tax. Some exceptions are discussed next.

Election to Exclude Employees From FICA Coverage

Churches and qualified church-controlled organizations (church organizations) can elect not to have their employees covered by FICA. To make the election, the church or church organization must certify to the IRS that, for religious reasons, it is opposed to paying employment taxes.

Making the election. To make this election, churches and church organizations file two copies of Form 8274, *Certification by Churches and Qualified Church-Controlled Organizations Electing Exemption From Employer Social Security and Medicare Taxes*. They file this after employees are hired, but before the first date on which a quarterly employment tax return is due (or would be due except for this election).

Revoking the election. The church or church organization can revoke this election. The revocation cannot be later reversed. Also, the IRS can revoke the election if certain filing requirements for information returns are not met.

Effect of election on employees. If you are an employee (other than a minister or member of a religious order) of a church or church organization that makes this election and they pay you \$108.28 or more in wages, you are responsible for paying self-employment taxes on those wages.

When figuring your self-employment income, do not reduce these wages (earnings) by any deductions and do not reduce any

Table 1. The Self-Employment Tax Exemption Application and Approval Process

Who Can Apply	Ministers, Members of Religious Orders, and Christian Science Practitioners	Member of Recognized Religious Sect
How	File Form 4361	File Form 4029
When	File by the due date (plus extensions) of your tax return for the second tax year with at least \$400 of net earnings from self-employment (at least part from qualified services)	File anytime
Approval	If approved, you will receive an approved copy of Form 4361	If approved, you will receive an approved copy of Form 4029
Effective Date	For all tax years after 1967 with at least \$400 of net earnings from self-employment	For all tax years after 1950, but not for years beginning before you meet the eligibility requirements

other self-employment earnings by any deduction related to these wages.

Election by Employees of Churches, etc., Who Choose Not to Pay Social Security Taxes

You may be able to choose to be exempt from social security and Medicare taxes, including the self-employment tax, if you work for a church (or church-controlled non-profit division) that does not pay the employer's part of the social security tax on wages. You can make the choice if you are a member of a religious sect or division opposed to social security and Medicare. This exemption does not apply to your service, if any, as a minister of a church or as a member of a religious order.

You can make this choice by filing Form 4029. See *Requesting Exemption — Form 4029*, later, under *Members of Recognized Religious Sects*.

Employee and employer opposed to social security and Medicare participation. If you and your employer (or, if your employer is a partnership, each partner) are members of a religious faith, or faiths, opposed to social security participation, you each can apply for exemption from the social security and Medicare taxes imposed on wages. See *Exemption From FICA Taxes*, later.

U.S. Citizens, Resident and Nonresident Aliens

To be covered under the self-employment tax provisions (SECA), individuals generally must be citizens or resident aliens of the United States. Nonresident aliens are not covered under SECA.

To determine your alien status, see Publication 519, *U.S. Tax Guide for Aliens*.

Residents of Puerto Rico, the Virgin Islands, Guam, and American Samoa. Residents of Puerto Rico, the Virgin Islands, Guam, and American Samoa, who are not U.S. citizens, are treated the same as citizens or resident aliens of the United States for self-employment tax purposes. For information on figuring the tax, see *Figuring Net Earnings From Self-Employment for SE Tax*, later.

Exemption From Self-Employment (SE) Tax

Members of religious orders who have not taken a vow of poverty, ministers, and Christian Science practitioners can request an exemption from self-employment tax.

Members of a recognized religious sect or a division of it can also apply for an exemption from the self-employment tax. For the rules that apply to this exemption, see *Members of Recognized Religious Sects*, later.

TIP *Members of religious orders who have taken a vow of poverty are exempt from paying self-employment tax, as discussed earlier under Members of Religious Orders. They do not have to request the exemption.*

Who cannot be exempt? If you elected before 1968 to be covered under social security for your ministerial services, you are still covered. You cannot be exempt from self-employment tax.

If you elected to be covered by social security by filing Form 2031 for your 1986 or 1987 tax year, you cannot be exempt from self-employment tax.

Requesting exemption. Table 1 briefly summarizes the procedure for requesting exemption from the self-employment tax. More detailed explanations follow.

CAUTION *An approved exemption only applies to earnings you receive for qualified services, discussed later. It does not apply to any other self-employment income.*

Ministers, Members of Religious Orders, and Christian Science Practitioners

To claim the exemption from self-employment tax, you must meet all of the following conditions:

- 1) File Form 4361, described later under *Requesting exemption — Form 4361*,

- 2) Be conscientiously opposed to public insurance because of your individual religious considerations (not because of your general conscience), or be opposed because of the principles of your religious denomination,
- 3) File for other than economic reasons,
- 4) Inform the ordaining, commissioning, or licensing body of your church or order that you are opposed to public insurance if you are a minister or a member of a religious order (other than a vow-of-poverty member),
- 5) Establish that the organization that ordained, commissioned, or licensed you, or your religious order, is a tax-exempt religious organization,
- 6) Establish that the organization is a church or a convention or association of churches, and
- 7) Sign and return the statement the IRS mails to you to certify that you are requesting an exemption based on the grounds listed on the statement.

Item (4) does not apply to Christian Science Practitioners.

Requesting exemption— Form 4361. To request exemption from self-employment tax, file Form 4361 in triplicate.

Form 4361 includes a statement certifying that you oppose, for your services as a member of the clergy, public (governmental) insurance for death, disability, old age, or retirement because of your conscience or religious principles. This includes insurance that helps pay for or provide services for medical care, and includes benefits from a system established by the Social Security Act.



The IRS will return to you a copy of the Form 4361 that you filed indicating whether your exemption has been approved. If it is approved, keep the approved copy in your permanent records.

When to file. File Form 4361 by the date your income tax return is due, including extensions, for the second tax year in which you have net earnings from self-employment of at least \$400. This rule applies if any part of your net earnings for each of the two years came from your services as a:

- ☞ Minister,
- ☞ Member of a religious order, or
- ☞ Christian Science practitioner.

The two years do not have to be consecutive tax years.



Because the approval process can take some time, you should file Form 4361 as soon as possible.

Example 1. Rev. Lawrence Jaeger, a clergyman ordained in 1997, has net earnings of \$450 in 1997 and \$500 in 1998. He must file his application for exemption by the due date, including extensions, for his 1998 income tax return. However, if Rev. Jaeger does not receive his exemption by April 15, 1998, his self-employment tax for 1997 is due by that date.

Example 2. Rev. Harry Wolfe has \$300 in net earnings as a clergyman in 1997, but earned more than \$400 in both 1996 and

1998. He must file his application for exemption by the due date, including extensions, for his 1998 income tax return. However, if he did not receive the exemption by April 15, 1997, his self-employment tax for 1996 was due by that date.

Example 3. In 1995, Rev. David Moss was ordained a minister and had \$700 in net earnings as a minister. In 1996, he received \$1,000 as a minister, but his related expenses were over \$1,000. Therefore, he had no net earnings as a minister in 1996. Also in 1996, he opened a book store and had \$8,000 in net self-employment earnings from the store. In 1997, he had net earnings of \$1,500 as a minister and \$10,000 net self-employment earnings from the store.

Because Rev. Moss had net earnings from self-employment in 1995 and 1997 that were more than \$400 each year, and part of the earnings in each of those years was for his services as a minister, he must file his application for exemption by the due date, including extensions, for his 1997 income tax return.

Death of individual. The right to file an application for exemption ends with an individual's death. A surviving spouse, executor, or administrator cannot file an exemption application for a deceased clergy member.

Effective date of exemption. An approved exemption is effective for all tax years after 1967 in which you have \$400 or more of net earnings from self-employment, part of which is for services as a member of the clergy.

Example. Rev. Thomas Austin, ordained in 1996, had over \$400 in net earnings as a minister in both 1996 and 1997. He files an application for exemption on February 15, 1998. If an exemption is granted, it is effective for 1996 and the following years.

Refunds of self-employment tax. If, after receiving an approved Form 4361, you find that you overpaid self-employment tax, you can file a claim for refund on Form 1040X before the statutory period ends. This is generally within 3 years from the date you filed the return or within 2 years from the date you paid the tax, whichever is later. A return you filed, or tax paid, before the due date is considered to have been filed or paid on the due date.

If you file a claim after the 3-year period but within 2 years from the time you paid the tax, the credit or refund will not be more than the tax you paid within the 2 years immediately before you file the claim.

Members of Recognized Religious Sects

If you are a member of a recognized religious sect, or a division of a recognized religious sect, you can apply for an exemption from payment of social security and Medicare taxes.

Exception. If you received social security benefits or payments, or anyone else received these benefits or payments based on your wages or self-employment income, you cannot apply. However, if you pay your benefits back, you may be considered for exemption. Contact your local Social Security office to find out the amount to be paid back.

Eligibility requirements. To claim this exemption from self-employment tax, *all* the following requirements must be met.

- 1) You must file Form 4029, discussed later under *Requesting exemption — Form 4029*.
- 2) As a follower of the established teachings of the sect or division, you must be conscientiously opposed to accepting benefits of any private or public insurance that makes payments for death, disability, old age, retirement, or medical care, or provides services for medical care.
- 3) You must waive all rights to receive any social security payment or benefit and agree that no benefits or payments will be made to anyone else based on your wages and self-employment income.
- 4) The Commissioner of Social Security must determine that:
 - a) Your sect or division has such established teachings,
 - b) It is the practice, and has been for a substantial period of time, for members of the sect or division to provide for their dependent members in a manner that is reasonable in view of the members' general level of living, and
 - c) The sect or division has existed at all times since December 31, 1950.

If you have previously received approval for exemption from self-employment tax, you are considered to have met the requirements and do not need to apply for this exemption.

Requesting exemption — Form 4029. To request the exemption, file Form 4029 in triplicate with the Social Security Administration at the address shown on the form. The sect or division must complete part of the form.



The IRS will return to you a copy of the Form 4029 that you filed indicating whether your exemption has been approved. If it is approved, keep the approved copy in your permanent records.

When to file. You can file Form 4029 at any time.


Effective date of exemption. An approved exemption generally is effective for all tax years beginning after 1950. It does not apply to any tax year beginning before you meet the eligibility requirements discussed earlier.

The exemption will end if you fail to meet the eligibility requirements or if the Commissioner of Social Security determines that the sect or division fails to meet them. You must notify the IRS within 60 days if you are no longer a member of the religious group, or if you no longer follow the established teachings of this group. The exemption will end effective with the date you notify the IRS.

Refunds of self-employment tax paid. For information on requesting refunds, see the discussion under *Ministers, Members of Religious Orders, and Christian Science Practitioners*, earlier.

Exemption From FICA Taxes

Generally, under FICA, the employer and the employee each pay half of the social security and Medicare tax. Both the employee and the employer, if they meet the eligibility requirements discussed earlier in this section, can apply to be exempt from their share of FICA taxes on wages paid by the employer to the employee.

 **TIP** *If the employer's application is approved, the exemption will apply only to FICA taxes on wages paid to employees who also received an approval of identical applications.*

Information for employers. If you have an approved Form 4029 and you have employees who have approved Form 4029s, do not report wages you paid to these employees as social security and Medicare wages.

A partnership in which each partner holds a religious exemption from social security and Medicare is an employer for this purpose.

Form W-2. When preparing a Form W-2 for an employee with an approved Form 4029, write "Form 4029" in the box marked "Other." Do not make any entries in box 3 or 5.

Forms 941 and 943. Do not include these exempt wages on Form 941, *Employer's Quarterly Federal Tax Return*, or on Form 943, *Employer's Annual Tax Return for Agricultural Employees* if you have received an approved Form 4029.

On Form 941, write "Form 4029" to the left of the entry spaces on the lines for "Taxable social security wages," "Taxable social security tips," and "Taxable Medicare wages and tips." Check the box on line 8 to show that the wages are not subject to these taxes.


On Form 943, write "Form 4029" to the left of the entry spaces on the lines for "Total wages subject to social security taxes," and "Total wages subject to Medicare taxes."

If you have employees who do not have an approved Form 4029, you must withhold the employee share of social security and Medicare taxes and pay the employer's share.

Effective date. An approved exemption from FICA becomes effective on the first day of the first calendar quarter after the quarter in which Form 4029 is filed. The exemption will end on the last day of the calendar quarter before the quarter in which the employer, employee, sect, or division fails to meet the requirements.

Qualified Services

The exemption from self-employment tax applies only to qualified services. Qualified services, in general, are the services you perform in the exercise of your ministry or in the exercise of your duties as required by your religious order. The exemption does not apply to any other self-employment income.

 **CAUTION** *If you do not have an exemption, amounts you receive for performing qualified services are subject to self-employment tax.*

The following discussions provide more detailed information on qualified services of ministers, members of religious orders, and Christian Science practitioners and readers.

Ministers

Most services you perform as a minister, priest, rabbi, etc., are qualified services. These services include:

- 1) Performing sacerdotal functions,
- 2) Conducting religious worship, and
- 3) Controlling, conducting, and maintaining religious organizations, boards, societies, and other integral agencies that are under the authority of a religious body that is a church or denomination.

You are considered to control, conduct, and maintain a religious organization if you direct, manage, or promote the organization's activities.

A religious organization is under the authority of a religious body that is a church or denomination if it is organized for and dedicated to carrying out the principles of a faith according to the requirements governing the creation of institutions of the faith.

Services for nonreligious organizations.

Your services for a nonreligious organization are qualified services if the services are assigned or designated by your church. Assigned or designated services qualify even if they do not involve performing sacerdotal functions or conducting religious worship.

If your services are not assigned or designated by your church, they are qualified services only if they involve performing sacerdotal functions or conducting religious worship.

Services that are not part of your ministry.

Income from services that are not qualified services is generally subject to FICA (not SECA) taxes under the rules that apply to workers in general. The following are not qualified services.

- 1) Services you perform for nonreligious organizations other than the services stated earlier.
- 2) Services you perform as a duly ordained, commissioned, or licensed minister of a church as an employee of the United States, the District of Columbia, a foreign government, or any of their political subdivisions. This is true even if you are performing sacerdotal functions or conducting religious worship. (For example, if you perform services as a chaplain in the Armed Forces of the United States, the services are not qualified services.)
- 3) Services you perform in a government-owned and operated hospital (services are considered performed by a government employee, not by a minister as part of the ministry). However, services that you perform at a church-related hospital or health and welfare institution, or a private nonprofit hospital, are considered to be part of the ministry.

Books or articles. Writing religious books or articles is considered to be in the exercise of your ministry. Royalty income from the sale of books or articles is not subject to the self-employment tax unless you elect to be covered by the social security and Medicare insurance system.

This rule also applies to members of religious orders and to Christian Science practitioners.

Members of Religious Orders

Services you perform as a member of a religious order in the exercise of duties required by the order are qualified services. The services are qualified because you perform them as an agent of the order.

For example, if you are directed to perform services for another agency of the supervising church or an associated institution, you are considered to perform the services as an agent of the order.

However, if you are directed to work outside the order, the employment will not be considered a duty required by the order unless:

- Your services are the kind that are ordinarily performed by members of the order, and
- Your services are part of the duties that must be exercised for, or on behalf of, the religious order as its agent.

Effect of employee status. Ordinarily, if your services are not considered directed or required of you by the order, you and the outside party for whom you work are considered employee and employer. In this case, your earnings from the services are taxed under the rules that apply to workers in general, not under the rules for services provided as agent for the order. This is true even if you have taken a vow of poverty.

Example. Mark Brown and Elizabeth Green are members of a religious order and have taken vows of poverty. They renounce all claims to their earnings. The earnings belong to the order.

Mark is a licensed attorney. The superiors of the order instructed him to get a job with a law firm. Mark joined a law firm as an employee and, as he requested, the firm made the salary payments directly to the order.

Elizabeth is a secretary. The superiors of the order instructed her to accept a job with the business office of the church that supervises the order. Elizabeth took the job and gave all her earnings to the order.

Mark's services **are not** duties required by the order. His earnings are subject to social security and Medicare tax under FICA and Federal income tax.

Elizabeth's services **are** considered duties required by the order. She is acting as an agent of the order and not as an employee of a third party. She does not include the earnings in gross income, and they are not subject to income tax withholding, social security and Medicare tax, or self-employment tax.

Christian Science Practitioners and Readers

The exemption from self-employment tax, discussed earlier, applies only to the services a Christian Science practitioner or reader performs in the exercise of that profession. If you do not have an exemption, amounts you receive for performing these qualified services are subject to self-employment tax.

Figuring Net Earnings From Self-Employment for SE Tax

Generally, your net earnings from self-employment is your gross income from your trade or business minus allowable business deductions.

For the self-employment tax, your net earnings from self-employment include your gross income from qualified services (see *Qualified Services*, earlier) minus the deductions related to that income.



If you have an approved exemption, or you are automatically exempt, do not include the income or deductions from qualified services in figuring your net earnings from self-employment.

For more information on net earnings from self-employment, get Publication 533.

Gross income. To figure your net earnings from self-employment (on Schedule SE (Form 1040)), include in gross income:

- Salaries and fees for your qualified services,
- Offerings you receive for marriages, baptisms, funerals, masses, etc.,
- The value of meals and lodging provided to you, your spouse, and your dependents for your employer's convenience, and
- The fair rental value of a parsonage provided to you (including the cost of utilities that are furnished) and the rental allowance (including an amount for payment of utilities) paid to you.

If a church pays any amount toward your income tax or self-employment tax, other than withholding the amount from your salary, it is income to you. You must include the amount in your gross income and self-employment income.

Example. Pastor Roger Adams receives an annual salary of \$16,500 as a full-time minister. The \$16,500 includes \$1,500 that is designated as a rental allowance to pay utilities. His church owns a parsonage that has a fair rental value of \$5,200 per year. Pastor Adams is given the use of the parsonage. He is not exempt from self-employment tax. His net earnings for self-employment tax purposes are \$21,700 (\$16,500 plus \$5,200).

The results would be the same if, instead of the use of the parsonage and receipt of the rental allowance for utilities, Pastor Adams had received an annual salary of \$21,700 of which \$6,700 (\$1,500 plus \$5,200) per year was designated as a rental allowance.

For the income tax treatment of these amounts, see *Exclusion of Rental Allowance and Fair Rental Value of a Parsonage under Income Tax Treatment of Certain Items*, later.

Overseas duty. Your net earnings from self-employment are determined without any foreign earned income exclusion or the foreign housing exclusion or deduction if you are a U.S. citizen or resident alien who is serving abroad and living in a foreign country.

Example. Paul Jones was the minister of a U.S. church in Mexico. He earned \$22,000 and was able to exclude it all for income tax purposes under the foreign earned income exclusion. Mr. Jones would, however, compute self-employment tax on \$22,000.

For information on excluding foreign earned income or the foreign housing amount, get Publication 54, *Tax Guide for U.S. Citizens and Resident Aliens Abroad*.

Specified U.S. possessions. The exclusion from gross income for amounts derived in Guam, American Samoa, or the Commonwealth of the Northern Mariana Islands does not apply in computing net earnings from self-employment. Also see *Residents of Puerto Rico, the Virgin Islands, Guam, and American Samoa*, earlier, under *U.S. Citizens, Resident and Nonresident Aliens*.

Amounts not included in gross income. Do not include the following amounts in gross income when figuring your net earnings from self-employment.

- Offerings that others made to the church.
- Contributions by your church to an annuity plan set up for you, including any salary reduction, that are not included in your gross income.
- Pension payments or retirement allowances you receive for your past qualified services.

Allowable deductions. To determine your net earnings from self-employment, deduct all your nonemployee ministerial expenses. Also, deduct all your allowable unreimbursed trade or business expenses that you incur in performing ministerial services as a common law employee of the church. Include this net amount on line 2 of Schedule SE (Form 1040).

Reimbursement arrangements. If you received an advance, allowance, or reimbursement for your expenses, how you report this amount and your expenses depends on whether the reimbursement was paid to you under an accountable plan or a nonaccountable plan. If you are not sure if you are reimbursed from an accountable plan or a nonaccountable plan, ask your employer.

Accountable plans. To be an accountable plan, your employer's reimbursement arrangement must require you to meet *all* of the following rules.

- 1) Your expenses must have a business connection — that is, you must have paid or incurred deductible expenses while performing services as an employee of your employer.
- 2) You must adequately account to your employer for these expenses within a reasonable period of time.
- 3) You must return any excess reimbursement or allowance within a reasonable period of time.

Generally, if your expenses equal your reimbursement, you have no deduction and the reimbursement is not reported on your Form W-2. If your expenses are more than your reimbursement, you can deduct your excess expenses for self-employment tax and income tax purposes.

Nonaccountable plan. A nonaccountable plan is a reimbursement arrangement under which you do not meet all three rules listed under *Accountable plans*. In addition, the following payments made under an accountable plan will be treated as being paid under a nonaccountable plan.

- 1) Excess reimbursements you fail to return to your employer.
- 2) Reimbursement of nondeductible expenses related to your employer's business.

Your employer will combine any reimbursement paid to you under a nonaccountable plan with your wages, salary, or other compensation. Your employer will report the combined total on your Form W-2. You can deduct your expenses (for self-employment tax and income tax purposes) regardless of whether they are more than, less than, or equal to your reimbursement.

For more information on accountable and nonaccountable plans get Publication 463, *Travel, Entertainment, Gift, and Car Expenses*.

Husband and Wife Missionary Team

If a husband and wife are both duly ordained, commissioned, or licensed ministers of a church and have an agreement that each will perform specific services for which they are paid jointly or separately, they must divide the self-employment income according to the agreement.

If the agreement is with one spouse only and the other spouse is not paid for any specific duties, amounts received for their services are included in only the self-employment income of the spouse having the agreement.

Maximum Earnings Subject to Self-Employment Tax

For 1997, the maximum net earnings from self-employment subject to social security (old age, survivor, and disability insurance) tax is \$65,400 minus any wages and tips you earned that were subject to social security tax. The tax rate is 12.4%. All of your net earnings are subject to the Medicare (hospital insurance) part of the self-employment tax. The tax rate is 2.9%.

Optional Methods for Figuring Net Earnings from Self-Employment

You may be able to use an optional method for figuring your net earnings from self-employment. In general, the optional methods are intended to permit continued coverage for social security and Medicare purposes when your income for the tax year is low.

There is an optional method for farmers and an optional method for nonfarm businesses. If you are in farm and nonfarm businesses, you may qualify for both options.

Farm optional method. If you are in the farming business, you may be able to use the farm optional method. For more information on the farm optional method, see Publication 533.

Nonfarm optional method. You may use the nonfarm optional method for nonfarm self-employment income if you meet **all** of the following tests.

- 1) Your net nonfarm profits are less than \$1,733.
- 2) Your net nonfarm profits are less than 72.189% of your total gross income from nonfarm self-employment.
- 3) You are self-employed or a partner on a regular basis. This means that your actual net earnings from self-employment are \$400 or more in at least 2 of the 3 tax years before the one for which you use this method.
- 4) You have not previously used this method more than 4 years (there is a 5-year lifetime limit). The years do not have to be consecutive.

If you meet these four tests, you may report the smaller of two-thirds of the gross income from your nonfarm business, or \$1,600 as your net earnings from self-employment.



You may not report less than your actual net earnings for nonfarm self-employment.

Income Tax Treatment of Certain Items

Some income and expense items are treated the same for income tax and self-employment tax purposes and some are treated differently.

Income Items

The tax treatment of offerings and fees, outside earnings, rental allowances, rental value of parsonage, pay of members of religious orders, and foreign earned income is discussed here.

Offerings and Fees

If you are a member of the clergy, you must include in your income offerings and fees you receive for marriages, baptisms, funerals, masses, etc., in addition to your salary. If the offering is made to the religious institution, it is not taxable to you.

Outside Earnings

If you are a member of a religious organization and you give your outside earnings to the organization, you still must include the earnings in your income. However, you may be entitled to a charitable contribution deduction for the amount paid to the organization. Get Publication 526, *Charitable Contributions*.

Exclusion of Rental Allowance and Fair Rental Value of a Parsonage

If you receive in your pay an amount officially designated as a rental allowance, you can exclude the allowance from your gross income if:

- 1) The amount is used to provide or rent a home, and

- 2) The amount is not more than reasonable pay for your services.

The term “rental allowance” includes an amount to pay utility costs.

You can exclude from gross income **the fair rental value** of a house or parsonage, including utilities, furnished to you as part of your pay. However, the exclusion cannot be more than the reasonable pay for your services. If you pay for the utilities, you can exclude any allowance designated for utility costs, up to your actual cost.

This exclusion applies only for income tax purposes. It does not apply for self-employment tax purposes, as discussed earlier under *Figuring Net Earnings From Self-Employment for SE Tax*.

This exclusion applies to ordained, commissioned, or licensed ministers of the gospel. To exclude the allowance, it must be provided as pay for your services, including:

- Qualified services, discussed earlier under *Ministers*,
- Administrative duties and teaching at theological seminaries, and
- The ordinary duties of a minister performed as an employee of the United States (other than as a chaplain in the Armed Forces), a state, possession, political subdivision, or the District of Columbia.

Example. Rev. Amos Baker is a full-time minister at the Central Mission Church. The church allows him to use the parsonage that has an annual fair rental value of \$4,800. The church pays him an annual salary of \$13,200, of which \$1,200 is designated for utility costs. His utility costs during the year were \$1,000.

For income tax purposes, Rev. Baker excludes \$5,800 from gross income (the fair rental value of the parsonage plus \$1,000 from the allowance for utility costs). He will report \$12,200 (\$12,000 salary and \$200 of unused utility allowance). His income for self-employment tax purposes, however, is \$18,000 (\$13,200 salary + \$4,800 fair rental value of the parsonage).

Home ownership. If you own your home and you receive as part of your pay a housing or rental allowance, you may exclude from gross income the smallest of the following:

- The amount actually used to provide a home,
- The amount officially designated as a rental allowance, or
- The fair rental value of the home, including furnishings, utilities, garage, etc.

You must include in gross income the amount of any rental allowance that is more than the smallest of your reasonable pay, the fair rental value of the home plus utilities, or the amount actually used to provide a home.



You may deduct the home mortgage interest and real estate taxes you pay on your home even though all or part of the mortgage is paid with funds you get through a tax-free rental or parsonage allowance.

Retired ministers. If you are a retired minister, you exclude from your **gross income** the rental value of a home (plus utilities) furnished to you by your church as a part of your pay for past services, or the part of your pension that was designated as a rental allowance. However, a minister's surviving spouse cannot exclude the rental value unless the rental value is for ministerial services he or she performs or performed.

Self-employment earnings. If you are a retired minister, you can exclude from your net earnings from self-employment the rental value of a parsonage or a parsonage allowance you are provided after you retire. This applies whether or not you can exclude the amount for income tax purposes. You can also exclude from your net earnings from self-employment any retirement benefits you receive from a church plan.

Theological students. If you are a theological student serving a required internship as a part-time or assistant pastor, you cannot exclude a parsonage or rental allowance from your income unless you are ordained, commissioned, or licensed as a minister.

Traveling evangelists. You can exclude a designated rental allowance from out-of-town churches if you meet all of the following requirements.

- 1) You are an ordained minister.
- 2) You perform qualified services at churches located away from your community.
- 3) You actually use the rental allowance to maintain your permanent home.

Jewish cantors. If you have a bona fide commission and your congregation employs you on a full-time basis to perform substantially all the religious functions of the Jewish faith, you can exclude a rental allowance from your gross income.

Pay — Members of Religious Orders

Your pay may be exempt from both income tax and self-employment tax if you are a member of a religious order who:

- Has taken a vow of poverty,
- Receives pay for services performed as an agent of the order and in the exercise of duties required by the order, and
- Renounces the pay and gives it to the order.

See *Members of Religious Orders*, earlier.

Foreign Earned Income

Certain income may be exempt from income tax if you work in a foreign country or in a specified U.S. possession. Publication 54, *Tax Guide for U.S. Citizens and Resident Aliens Abroad*, discusses the foreign earned income exclusion. Publication 570, *Tax Guide for Individuals With Income From U.S. Possessions*, covers the rules for taxpayers in U.S. possessions. You may get these free publications from the Internal Revenue Service or from most U.S. Embassies or consulates.

Expense Items

The tax treatment of ministerial trade or business expenses, expenses allocable to tax-free income, and health insurance costs is discussed here.

Ministerial Trade or Business Expenses as an Employee

When you figure your income tax, you must itemize your deductions on Schedule A (Form 1040) to claim allowable deductions for ministerial trade or business expenses incurred while working as an employee. You may also have to file Form 2106, *Employee Business Expenses* (or Form 2106-EZ).

These expenses are claimed as miscellaneous itemized deductions and are subject to the 2% of adjusted gross income (AGI) limit. See Publication 529, *Miscellaneous Deductions*, for more information on this limit.

Additionally, these expenses may have to be reduced by the amount that is allocable to tax-free income (discussed next) before being limited by the 2% AGI limit.

Expenses Allocable to Tax-Free Income

The income and deductions relative to your ministry include amounts related to ministerial duties you perform both as an employee and as a self-employed person.

If you receive a rental or parsonage allowance that is exempt from income tax (tax-free), you must allocate a portion of the expenses of operating your ministry to that tax-free income. You cannot deduct the portion of your expenses that is allocated to your tax-free rental or parsonage allowance.

Exception. This rule does not apply to your deductions for home mortgage interest or real estate taxes on your home.

Figuring the allocation. Figure the portion of your otherwise deductible expenses that you cannot deduct (because that portion must be allocated to tax-free income) by multiplying the expenses by a fraction.

The fraction's numerator is the tax-free rental or parsonage allowance. The denominator is all income (both taxable and tax-free) earned from your ministry.



Reduce your deductible expenses only in figuring your income tax, not your self-employment tax.

Required statement. If you receive a tax-free rental or parsonage allowance and have ministerial expenses, attach a statement to your tax return. The statement must contain all of the following information:

- 1) A list of each item of taxable ministerial income by source (such as wages, salary, weddings, baptisms, etc.) plus the amount,
- 2) A list of each item of tax-free ministerial income by source (parsonage allowance) plus the amount,
- 3) A list of each item of otherwise deductible ministerial expenses plus the amount,
- 4) How you figured the nondeductible part of your otherwise deductible expenses, and

- 5) A statement that the other deductions claimed on your tax return are not allocable to your tax-free income.

See the statement prepared for the *Comprehensive Example*, later.

Example. Rev. Charles Ashford received \$40,000 in ministerial earnings consisting of: a \$28,000 salary for ministerial services; \$2,000 for weddings and baptisms; and a \$10,000 tax-free housing allowance. He incurred \$4,000 of unreimbursed expenses connected with his ministerial earnings. \$3,500 of the \$4,000 is related to his ministerial salary, and \$500 is related to his wedding and baptism income. He figures the unallowable part of his expenses as follows:

- 1) $\$10,000 \div \$40,000 = 25\%$;
- 2) $\$3,500 \times 25\% = \875 ;
- 3) $\$500 \times 25\% = \125 .

\$875 of the \$3,500 salary-related expenses is not deductible, and \$125 of the \$500 self-employment related expenses is not deductible.

Health Insurance Costs of Self-Employed Ministers

If you are self-employed, you may be able to deduct a percentage of the amount you pay for medical insurance coverage for yourself and your family. For 1997, the percentage is 40%.



For 1998, the deduction percentage will increase to 45%.

You can take this deduction even if you do not itemize deductions on Schedule A (Form 1040). You take the deduction as an adjustment to income on Form 1040. The expenses taken into account for purposes of this deduction are not allowed as a medical expense deduction on Schedule A.



You cannot take the deduction for any month you can participate in a subsidized plan of your or your spouse's employer. For more information, see Publication 535.

Your deduction cannot exceed your net earnings from the business under which the insurance plan is established. Also, the amount you deduct does not reduce your income for self-employment tax purposes.

Common-law employee. As a common-law employee (discussed earlier) of the church, you are not considered to be a self-employed individual for the income from that employment. Do not include that income when determining if your deduction exceeds your net earnings.

Deduction for Self-Employment Tax

You can deduct one-half of your self-employment tax as a business expense in figuring adjusted gross income. This is an income tax deduction only, and you deduct it on line 26 of Form 1040.



It is not a deduction in figuring net earnings from self-employment subject to self-employment tax.

Income Tax Withholding and Estimated Tax

If you are a duly ordained, commissioned, or licensed minister, a member of a religious order (who has not taken a vow of poverty), or a Christian Science practitioner, and you perform qualified services, your salary is subject to income tax. However, it is generally not subject to federal income tax withholding.

If your salary is not subject to withholding, you should make estimated tax payments to avoid penalties for not paying tax as you earn your income. For more information, see *Payment of Estimated Tax*, later.

If you perform your services as an employee of the church (under the common law rules) and your pay is not subject to income tax withholding, you can enter into a voluntary withholding agreement with your employer, the church, to cover any income and self-employment tax that may be due.

Filing Your Return

Even if you are not otherwise required to file, you must file an income tax return on Form 1040 if:

- You are not exempt from self-employment tax, and you have net earnings from self-employment (discussed earlier under *Figuring Net Earnings From Self-Employment for SE Tax*) of \$400 or more in the tax year,
- You are exempt from self-employment tax on earnings from qualified services and you have \$400 or more of other earnings subject to self-employment tax, or
- You had wages of \$108.28 or more from an electing church or church-controlled organization (discussed earlier under *Religious Workers*).

Self-employment tax. If you are liable for self-employment tax, you must file Schedule SE (Form 1040) with your return. Publication 533 has information about completing the schedule.

Exemption from self-employment tax.

If you filed Form 4361 and received IRS approval not to be taxed on those earnings, and you do not have any other income subject to self-employment tax, do not file Schedule SE. Instead, write "Exempt—Form 4361" on Form 1040, line 47.

If you filed Form 4029 and received IRS approval not to be taxed on those earnings, and you do not have any other income subject to self-employment tax, do not file Schedule SE. Instead, write "Form 4029" on Form 1040, line 47.

For more information on filing your return, including when and where to file it, see the instructions for Form 1040.

Payment of Estimated Tax

Estimated tax is the method used to pay income, self-employment, and other taxes you report on Form 1040 for income that is either not subject to withholding, or from which not enough tax is withheld. Your estimated tax is your expected tax for the year minus your expected withholding and credits.

Generally, you must make estimated tax payments if your estimated tax for the year will be \$500 or more.

Determine your estimated tax by using the worksheet in Form 1040-ES. Then, using the Form 1040-ES payment-voucher, pay the entire estimated tax or the first installment by April 15, 1998. The April 15th date applies whether or not your tax home and your abode are outside the United States and Puerto Rico.

For more information get Publication 505, *Tax Withholding and Estimated Tax*.

Retirement Savings Arrangements

Retirement plans for the self-employed.

To set up a qualified retirement plan (such as a Keogh (H.R. 10) plan, a simplified employee pension (SEP) plan, or a SIMPLE plan), you must be self-employed.

Ministers, members of religious orders, and Christian Science practitioners and readers treat their pay for qualified services (discussed earlier) as self-employment earnings for social security and Medicare taxes.

The common law rules determine whether you are an employee or a self-employed person for purposes of setting up a retirement plan for the self-employed. See *Employment Status for Other Tax Purposes*, earlier.

For example, if a congregation pays a minister a salary for performing qualified services, and the minister is subject to the congregation's control, the minister is a common-law employee. The minister is not a self-employed person for purposes of setting up a retirement plan. This is true even though, for social security and Medicare purposes, his or her pay is counted when figuring net earnings from self-employment.

On the other hand, amounts received directly from members of the congregation, such as fees for performing marriages, baptisms, or other personal services, are earnings from self-employment for all tax purposes.

For more information on establishing a Keogh, SEP, or SIMPLE plan, get Publication 560, *Retirement Plans for Small Business*.

Individual retirement arrangements (IRAs).

You generally are allowed to make contributions to your IRA of up to \$2,000 or the amount of your pay, whichever is less. These contributions may be fully or partly deductible, or nondeductible, if you or your spouse is covered by an employer retirement plan (including a Keogh, SEP, or SIMPLE plan). If you are covered (or considered covered), the amount of your deduction is affected by your income and your filing status.

For more information on IRAs, get Publication 590.

Church plans. If you are a duly ordained, commissioned, or licensed minister working as a minister or chaplain, and are self-employed or employed by an organization that is not a tax-exempt organization, you can participate in a church plan. For more information, see Publication 571, *Tax-Sheltered Annuity Programs for Employees of Public Schools and Certain Tax-Exempt Organizations*.

Earned Income Credit

If you qualify for it, the earned income credit reduces the tax you owe. Even if you do not owe tax, you can get a refund of the credit. Depending on your situation, the credit can be as high as \$3,656. Also, you may be able to get part of the credit added to your pay instead of waiting until after the end of the year.

You cannot take the credit if your earned income (or modified adjusted gross income, if greater) is more than:

- \$9,770 if you do not have a qualifying child,
- \$25,760 if you have one qualifying child, or
- \$29,290 if you have more than one qualifying child.

Earned Income. Earned income includes your:

- Wages, salaries, tips, and other pay, and
- Net earnings from self-employment minus the amount you claimed (or should have claimed) on Form 1040, line 26, for one-half of your self-employment tax.

Earned income for a minister with an approved Form 4361.

If you have earnings from qualified services that are exempt from SECA (have an approved Form 4361), amounts you received for performing ministerial duties as an employee are earned income. This includes wages, salaries, tips, and other employee pay. It also includes pay that is not taxed, such as the housing and utility allowance received as part of your pay for services as an employee.

Amounts you received for nonemployee ministerial duties are not earned income. This includes fees for performing marriages, baptisms, and honoraria for delivering speeches.

If you had nonministerial duties, any net earnings from self-employment, minus one-half of your self-employment tax, or any pay received as an employee is earned income.

Earned income for a minister whose income from qualified services is not exempt from SECA. Earned income includes your net earnings from self-employment plus any pay you received for nonministerial duties minus your Form 1040, line 26, amount for one-half of self-employment tax.

Your net earnings from self-employment includes those net earnings from qualified services. See *Figuring Net Earnings From Self-Employment for SE Tax*, earlier. Net earnings also includes net earnings from self-employment related to nonministerial duties.

Earned income for a member of a recognized religious sect with an approved Form 4029.

If you have an approved Form 4029, all wages, salaries, tips, and other employee compensation are earned income. Amounts you received as a self-employed individual are not earned income. Also, losses from Schedules C, C-EZ, or F cannot be subtracted from wages on line 7 of Form 1040.

Where to get information. For the detailed rules on this credit, get Publication 596. You may need to complete Schedule EIC and attach it to your tax return. To figure the amount of your credit, you will have to fill out a work-

sheet or have the IRS compute the credit for you. For details on getting part of the credit added to your pay, get Form W-5 from your employer or by calling the IRS at 1-800-TAX-FORM (1-800-829-3676).

How To Get More Information



You can get help from the IRS in several ways.

Free publications and forms. To order free publications and forms, call 1-800-TAX-FORM (1-800-829-3676). You can also write to the IRS Forms Distribution Center nearest you. Check your income tax package for the address. Your local library or post office also may have the items you need.

For a list of free tax publications, order Publication 910, *Guide to Free Tax Services*. It also contains an index of tax topics and related publications and describes other free tax information services available from the IRS, including tax education and assistance programs.

If you have access to a personal computer and modem, you also can get many forms and publications electronically. See *Quick and Easy Access to Tax Help and Forms* in your income tax package for details.

Tax questions. You can call the IRS with your tax questions. Check your income tax package or telephone book for the local number, or you can call 1-800-829-1040.

TTY/TDD equipment. If you have access to TTY/TDD equipment, you can call 1-800-829-4059 to ask tax questions or to order forms and publication. See your income tax package for the hours of operation.

Evaluating the quality of our telephone services. To ensure that IRS representatives give accurate, courteous, and professional answers, we evaluate the quality of our "800 number" telephone services in several ways.

- A second IRS representative sometimes monitors live telephone calls. That person only evaluates the IRS assistant and does not keep a record of any taxpayer's name or tax identification number.
- We sometimes record telephone calls to evaluate IRS assistants objectively. We hold these recordings no longer than one week and use them only to measure the quality of assistance.
- We value our customers' opinions. Throughout this year, we will be surveying our customers for their opinions on our service.

Comprehensive Example

Rev. John Michaels is the minister of the First United Church. He is married and has one child. He is a common-law employee of the

church, and he has not applied for an exemption from self-employment tax. The church paid him a salary of \$31,000. In addition, as a self-employed person, he earned \$4,000 during the year for weddings, baptisms, and honoraria.

In an earlier year, Rev. Michaels bought a home next to the church. He makes an \$800 per month mortgage payment of principal and interest only. The church paid him \$800 per month as his parsonage allowance (excluding utilities). The home's fair rental value is \$900 per month. The utility bills for the year totaled \$960. The church paid him \$100 per month designated as an allowance for utility costs.

The church did not withhold social security, Medicare, or federal income taxes because Rev. Michaels had not requested it. The church reports his salary for income tax purposes on Form W-2, box 1, leaving blank the boxes for social security and Medicare wages. Box 1 of the Form W-2 shows his wages of \$31,000. He made estimated tax payments during the year totaling \$8,400.

Rev. Michaels taught a course at a local community college. He was paid \$3,400, which was reported on a Form W-2. The federal income tax withheld was \$272. As an employee of the college, he was subject to social security and Medicare withholding. His Form W-2 shows \$210.80 withheld for social security taxes and \$49.30 withheld for Medicare taxes.

Form 1040

On Form 1040, Rev. Michaels reports \$34,400 (\$31,000 from the church and \$3,400 from the college) on line 7 and \$240 (the excess of the utility allowance over the utility costs) on line 21. (The parsonage allowance is not taxable for income tax purposes.)

Schedule C-EZ (Form 1040)

On Schedule C-EZ, Rev. Michaels reports the \$4,000 from weddings, baptisms, and honoraria. His related expenses for the year were \$87 for marriage and family booklets and \$156 for 495 miles of business use of his car (mainly for trips in connection with honoraria) figured at the standard mileage rate of 31.5 cents a mile. He cannot deduct the part of his expenses allocable to his tax-free income. He attaches the required statement (example shown later) to his tax return that explains how he figured the nondeductible part (\$56). He subtracts the \$56 from the \$243 and enters the \$187 difference on line 2 of Schedule C-EZ. He reports his net profit of \$3,813 on line 12 of Form 1040.

Schedule SE (Form 1040)

On Schedule SE, Rev. Michaels includes the \$800 per month parsonage allowance (\$9,600), the entire \$100 per month utility allowance (\$1,200), his salary from the church (\$31,000), and the net income from Schedule C-EZ (\$3,813). He subtracts from this the \$56 of nondeductible Schedule C-EZ expenses and the \$1,103 (\$884 + \$219) of allowable employee business expenses (discussed below). He reports his net income of \$44,454 in Section A of Schedule SE. (As a minister, his church salary is not considered "church employee income".)

After completing Schedule SE (Form 1040), Rev. Michaels enters the self-employment tax (\$6,281) on Form 1040, line 47. Also, he enters half of this amount (\$3,141) on Form 1040, line 26.

Form 2106-EZ

Rev. Michaels completes lines 7-11b. His car was used 2,806 miles for church business. Using the standard mileage rate, he figures that his car expense is \$884. He enters the \$884 on line 1. He has \$219 of expenses for publications and booklets that he enters on line 4.

Before entering the total expenses on line 6, he must reduce them by the amount that is allocable to his tax-free parsonage allowance. On the attached required statement (shown later), he shows how he figured the nondeductible part of his expense. The result is \$254 of expenses allocable to the tax-free income. He subtracts \$254 from \$1,103 and enters the result, \$849, on line 6. He then enters the line 6 amount on line 20 of Schedule A (Form 1040).

Schedule A (Form 1040)

Rev. Michaels contributed \$4,800 in cash during the year to various qualifying charities. Each individual contribution was for less than \$250. He deducts the \$4,800 as an itemized deduction on line 15. He deducts \$1,750 in real estate taxes on line 6 and \$6,810 of home mortgage interest on line 10. He limits his employee business expenses to the amount exceeding 2% of his adjusted gross income. He enters \$143 as the total of his miscellaneous deductions on line 26. The total of all itemized deductions is \$13,503, which he enters on line 28 of Schedule A and on line 35 of Form 1040.

a Control number		OMB No. 1545-0008					
b Employer's identification number 00-1357913		1 Wages, tips, other compensation 3400.00		2 Federal income tax withheld 272.00			
c Employer's name, address, and ZIP code Hometown College 40 Honor Rd. Hometown, Texas 77099		3 Social security wages 3400.00		4 Social security tax withheld 210.80			
		5 Medicare wages and tips 3400.00		6 Medicare tax withheld 49.30			
		7 Social security tips		8 Allocated tips			
d Employee's social security number 011-00-2222		9 Advance EIC payment		10 Dependent care benefits			
e Employee's name, address, and ZIP code John E. Michaels 1040 Main St. Hometown, Texas 77099		11 Nonqualified plans		12 Benefits included in box 1			
		13 See Instrs. for box 13		14 Other			
		15 Statutory employee <input type="checkbox"/>		Deceased <input type="checkbox"/>	Pension plan <input type="checkbox"/>	Legal rep. <input type="checkbox"/>	Hshld. emp. <input type="checkbox"/>
16 State	Employer's state I.D. No.	17 State wages, tips, etc.	18 State income tax	19 Locality name	20 Local wages, tips, etc.	21 Local income tax	

Department of the Treasury—Internal Revenue Service

Form **W-2 Wage and Tax Statement** **1997**
Copy B To Be Filed With Employee's FEDERAL Tax Return

This information is being furnished to the Internal Revenue Service.

a Control number		OMB No. 1545-0008					
b Employer's identification number 00-0246810		1 Wages, tips, other compensation 31000.00		2 Federal income tax withheld			
c Employer's name, address, and ZIP code First United Church 1042 Main St. Hometown, Texas 77099		3 Social security wages		4 Social security tax withheld			
		5 Medicare wages and tips		6 Medicare tax withheld			
		7 Social security tips		8 Allocated tips			
d Employee's social security number 011-00-2222		9 Advance EIC payment		10 Dependent care benefits			
e Employee's name, address, and ZIP code John E. Michaels 1040 Main St. Hometown, Texas 77099		11 Nonqualified plans		12 Benefits included in box 1			
		13 See Instrs. for box 13		14 Other Parsonage Allowance -- 9600.00 Utilities Allowance -- 1200.00			
		15 Statutory employee <input type="checkbox"/>		Deceased <input type="checkbox"/>	Pension plan <input type="checkbox"/>	Legal rep. <input type="checkbox"/>	Hshld. emp. <input type="checkbox"/>
16 State	Employer's state I.D. No.	17 State wages, tips, etc.	18 State income tax	19 Locality name	20 Local wages, tips, etc.	21 Local income tax	

Department of the Treasury—Internal Revenue Service

Form **W-2 Wage and Tax Statement** **1997**
Copy B To Be Filed With Employee's FEDERAL Tax Return

This information is being furnished to the Internal Revenue Service.

For the year Jan. 1–Dec. 31, 1997, or other tax year beginning , 1997, ending , 19 OMB No. 1545-0074

Label

(See instructions on page 10.)

Use the IRS label. Otherwise, please print or type.

Presidential Election Campaign (See page 10.)

Label information table with fields for name, address, and social security numbers.

Your social security number and Spouse's social security number fields.

For help in finding line instructions, see pages 2 and 3 in the booklet.

Yes/No table for Presidential Election Campaign with a note about checking 'Yes'.

Filing Status

Check only one box.

Filing status options: 1 Single, 2 Married filing joint return, 3 Married filing separate return, 4 Head of household, 5 Qualifying widow(er).

Exemptions

If more than six dependents, see page 10.

Exemptions section including 6a Yourself, 6b Spouse, 6c Dependents table, and 6d Total number of exemptions claimed.

Income

Attach Copy B of your Forms W-2, W-2G, and 1099-R here.

If you did not get a W-2, see page 12.

Enclose but do not attach any payment. Also, please use Form 1040-V.

Income section with lines 7 through 22, including wages, interest, dividends, and total income.

Adjusted Gross Income

If line 32 is under \$29,290 (under \$9,770 if a child did not live with you), see EIC inst. on page 21.

Adjusted Gross Income section with lines 23 through 32, including deductions and final adjusted gross income.

Tax Computation

33 Amount from line 32 (adjusted gross income) **33** 35,312

34a Check if: You were 65 or older, Blind; Spouse was 65 or older, Blind. Add the number of boxes checked above and enter the total here **34a**

b If you are married filing separately and your spouse itemizes deductions or you were a dual-status alien, see page 18 and check here **34b**

35 Enter the larger of your: **Itemized deductions** from Schedule A, line 28, **OR Standard deduction** shown below for your filing status. **But** see page 18 if you checked any box on line 34a or 34b or someone can claim you as a dependent. **35** 13,503

- Single—\$4,150 • Married filing jointly or Qualifying widow(er)—\$6,900
- Head of household—\$6,050 • Married filing separately—\$3,450

36 Subtract line 35 from line 33 **36** 21,809

37 If line 33 is \$90,900 or less, multiply \$2,650 by the total number of exemptions claimed on line 6d. If line 33 is over \$90,900, see the worksheet on page 19 for the amount to enter **37** 7,950

38 **Taxable income.** Subtract line 37 from line 36. If line 37 is more than line 36, enter -0- **38** 13,589

39 **Tax.** See page 19. Check if any tax from a Form(s) 8814 b Form 4972 **39** 2,038

Credits

40 Credit for child and dependent care expenses. Attach Form 2441 **40**

41 Credit for the elderly or the disabled. Attach Schedule R **41**

42 Adoption credit. Attach Form 8839 **42**

43 Foreign tax credit. Attach Form 1116 **43**

44 Other. Check if from a Form 3800 b Form 8396 c Form 8801 d Form (specify) **44**

45 Add lines 40 through 44 **45**

46 Subtract line 45 from line 39. If line 45 is more than line 39, enter -0- **46** 2,038

Other Taxes

47 Self-employment tax. Attach Schedule SE **47** 6,281

48 Alternative minimum tax. Attach Form 6251 **48**

49 Social security and Medicare tax on tip income not reported to employer. Attach Form 4137 **49**

50 Tax on qualified retirement plans (including IRAs) and MSAs. Attach Form 5329 if required **50**

51 Advance earned income credit payments from Form(s) W-2 **51**

52 Household employment taxes. Attach Schedule H. **52**

53 Add lines 46 through 52. This is your **total tax**. **53** 8,319

Payments

54 Federal income tax withheld from Forms W-2 and 1099 **54** 272

55 1997 estimated tax payments and amount applied from 1996 return **55** 8,400

56a **Earned income credit.** Attach Schedule EIC if you have a qualifying child b Nontaxable earned income: amount and type **56a**

57 Amount paid with Form 4868 (request for extension) **57**

58 Excess social security and RRTA tax withheld (see page 27) **58**

59 Other payments. Check if from a Form 2439 b Form 4136 **59**

60 Add lines 54, 55, 56a, 57, 58, and 59. These are your **total payments** **60** 8,672

Refund

61 If line 60 is more than line 53, subtract line 53 from line 60. This is the amount you **OVERPAID** **61** 353

62a Amount of line 61 you want **REFUNDED TO YOU**. **62a**

▶ b Routing number ▶ c Type: Checking Savings

▶ d Account number

63 Amount of line 61 you want **APPLIED TO YOUR 1998 ESTIMATED TAX** ▶ **63** 353

Amount You Owe

64 If line 53 is more than line 60, subtract line 60 from line 53. This is the **AMOUNT YOU OWE**. For details on how to pay, see page 27 **64**

65 Estimated tax penalty. Also include on line 64 **65**

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Sign Here

Your signature John E. Michaels	Date 2/14/98	Your occupation Minister
Spouse's signature. If a joint return, BOTH must sign. Susan R. Michaels	Date 2/14/98	Spouse's occupation Housewife

Paid Preparer's Use Only

Preparer's signature	Date	Check if self-employed <input type="checkbox"/>	Preparer's social security no.
Firm's name (or yours if self-employed) and address			EIN
			ZIP code

SCHEDULES A&B
(Form 1040)

Schedule A—Itemized Deductions

OMB No. 1545-0074

1997

Attachment
Sequence No. **07**

Department of the Treasury
Internal Revenue Service

(Schedule B is on back)

▶ **Attach to Form 1040.** ▶ See Instructions for Schedules A and B (Form 1040).

Name(s) shown on Form 1040

John E. Michaels and Susan R. Michaels

Your social security number

011 00 2222

Medical and Dental Expenses	1	Medical and dental expenses (see page A-1)	1			
	2	Enter amount from Form 1040, line 33, 2				
	3	Multiply line 2 above by 7.5% (.075)	3			
	4	Subtract line 3 from line 1. If line 3 is more than line 1, enter -0-				4
Taxes You Paid (See page A-2.)	5	State and local income taxes	5			
	6	Real estate taxes (see page A-2)	6	1,750		
	7	Personal property taxes	7			
	8	Other taxes. List type and amount ▶	8			
	9	Add lines 5 through 8				9 1,750
Interest You Paid (See page A-2.)	10	Home mortgage interest and points reported to you on Form 1098	10	6,810		
	11	Home mortgage interest not reported to you on Form 1098. If paid to the person from whom you bought the home, see page A-3 and show that person's name, identifying no., and address ▶	11			
	12	Points not reported to you on Form 1098. See page A-3 for special rules	12			
	13	Investment interest. Attach Form 4952 if required. (See page A-3.)	13			
Note: Personal interest is not deductible.	14	Add lines 10 through 13				14 6,810
Gifts to Charity If you made a gift and got a benefit for it, see page A-3.	15	Gifts by cash or check. If you made any gift of \$250 or more, see page A-3	15	4,800		
	16	Other than by cash or check. If any gift of \$250 or more, see page A-3. You MUST attach Form 8283 if over \$500	16			
	17	Carryover from prior year	17			
	18	Add lines 15 through 17				18 4,800
Casualty and Theft Losses	19	Casualty or theft loss(es). Attach Form 4684. (See page A-4.)				19
Job Expenses and Most Other Miscellaneous Deductions (See page A-5 for expenses to deduct here.)	20	Unreimbursed employee expenses—job travel, union dues, job education, etc. You MUST attach Form 2106 or 2106-EZ if required. (See page A-4.) ▶	20	849		
	21	Tax preparation fees	21			
	22	Other expenses—investment, safe deposit box, etc. List type and amount ▶	22			
	23	Add lines 20 through 22	23	849		
	24	Enter amount from Form 1040, line 33, 24 35,312	24			
	25	Multiply line 24 above by 2% (.02)	25	706		
26	Subtract line 25 from line 23. If line 25 is more than line 23, enter -0-				26 143	
Other Miscellaneous Deductions	27	Other—from list on page A-5. List type and amount ▶				27
Total Itemized Deductions	28	Is Form 1040, line 33, over \$121,200 (over \$60,600 if married filing separately)? NO. Your deduction is not limited. Add the amounts in the far right column for lines 4 through 27. Also, enter on Form 1040, line 35, the larger of this amount or your standard deduction. YES. Your deduction may be limited. See page A-5 for the amount to enter.	28			13,503

For Paperwork Reduction Act Notice, see Form 1040 instructions.

Cat. No. 11330X

Schedule A (Form 1040) 1997

**SCHEDULE C-EZ
(Form 1040)**

Department of the Treasury
Internal Revenue Service

Net Profit From Business

(Sole Proprietorship)

▶ Partnerships, joint ventures, etc., must file Form 1065.

▶ Attach to Form 1040 or Form 1041. ▶ See instructions on back.

OMB No. 1545-0074

1997

Attachment
Sequence No. **09A**

Name of proprietor

John E. Michaels

Social security number (SSN)

011 00 2222

Part I General Information

**You May Use
This Schedule
Only If You:**

- Had business expenses of \$2,500 or less.
- Use the cash method of accounting.
- Did not have an inventory at any time during the year.
- Did not have a net loss from your business.
- Had only one business as a sole proprietor.

And You:

- Had no employees during the year.
- Are not required to file **Form 4562**, Depreciation and Amortization, for this business. See the instructions for Schedule C, line 13, on page C-3 to find out if you must file.
- Do not deduct expenses for business use of your home.
- Do not have prior year unallowed passive activity losses from this business.

A Principal business or profession, including product or service
Minister

B Enter principal business code
(see page C-6) ▶ 8 | 7 | 7 | 1

C Business name. If no separate business name, leave blank.

D Employer ID number (EIN), if any

E Business address (including suite or room no.). Address not required if same as on Form 1040, page 1.
1042 Main Street
City, town or post office, state, and ZIP code
Hometown, TX 77099

Part II Figure Your Net Profit

1 Gross receipts. Caution: If this income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked, see Statutory Employees in the instructions for Schedule C, line 1, on page C-2 and check here ▶ <input type="checkbox"/>	4,000	
2 Total expenses. If more than \$2,500, you must use Schedule C. See instructions	187	*
3 Net profit. Subtract line 2 from line 1. If less than zero, you must use Schedule C. Enter on Form 1040, line 12 , and ALSO on Schedule SE, line 2 . (Statutory employees do not report this amount on Schedule SE, line 2. Estates and trusts, enter on Form 1041, line 3.)	3,813	

Part III Information on Your Vehicle. Complete this part **ONLY** if you are claiming car or truck expenses on line 2.

- 4** When did you place your vehicle in service for business purposes? (month, day, year) ▶ 7 / 15 / 95 .
- 5** Of the total number of miles you drove your vehicle during 1997, enter the number of miles you used your vehicle for:
- a** Business 495 **b** Commuting -0- **c** Other 7,309
- 6** Do you (or your spouse) have another vehicle available for personal use? **Yes** **No**
- 7** Was your vehicle available for use during off-duty hours? **Yes** **No**
- 8a** Do you have evidence to support your deduction? **Yes** **No**
- b** If "Yes," is the evidence written? **Yes** **No**

For Paperwork Reduction Act Notice, see Form 1040 instructions.

Cat. No. 14374D

Schedule C-EZ (Form 1040) 1997

* See Attached Statement

Unreimbursed Employee Business Expenses

1997

Attachment
Sequence No. **54A**

Department of the Treasury
Internal Revenue Service

▶ **Attach to Form 1040.**

Your name <p style="margin: 0;">John E. Michaels</p>	Social security number <p style="margin: 0; text-align: center;">011 : 00 : 2222</p>	Occupation in which you incurred expenses <p style="margin: 0; text-align: center;">Minister</p>
---	---	---

Part I General Information

You May Use This Form ONLY if All of the Following Apply:

- You are an employee deducting expenses attributable to your job.
- You **do not** get reimbursed by your employer for any expenses (amounts your employer included in box 1 of your Form W-2 are not considered reimbursements).
- If you are claiming vehicle expense,
 - a You own your vehicle, and
 - b You are using the standard mileage rate for 1997 **and** also used it for the year you first placed the vehicle in service.

Part II Figure Your Expenses

1 Vehicle expense using the standard mileage rate. Complete Part III and multiply line 8a by 31½¢ (.315)	1	884	
2 Parking fees, tolls, and transportation, including train, bus, etc., that did not involve overnight travel or commuting to and from work	2		
3 Travel expense while away from home overnight, including lodging, airplane, car rental, etc. Do not include meals and entertainment	3		
4 Business expenses not included on lines 1 through 3. Do not include meals and entertainment	4	219	
5 Meals and entertainment expenses: \$ _____ x 50% (.50)	5		
6 Total expenses. Add lines 1 through 5. Enter here and on line 20 of Schedule A (Form 1040). (Fee-basis state or local government officials, qualified performing artists, and individuals with disabilities: See the instructions for special rules on where to enter this amount.)	6	849	*

Part III Information on Your Vehicle. Complete this part ONLY if you are claiming vehicle expense on line 1.

- 7 When did you place your vehicle in service for business purposes? (month, day, year) ▶ 7 / 15 / 95
- 8 Of the total number of miles you drove your vehicle during 1997, enter the number of miles you used your vehicle for:
- a Business 2,806 b Commuting -0- c Other 4,998
- 9 Do you (or your spouse) have another vehicle available for personal use? **Yes** **No**
- 10 Was your vehicle available for use during off-duty hours? **Yes** **No**
- 11a Do you have evidence to support your deduction? **Yes** **No**
- b If "Yes," is the evidence written? **Yes** **No**

General Instructions

Section references are to the Internal Revenue Code.

Changes To Note

- The standard mileage rate has been increased to 31½ cents for each mile of business use in 1997.
- For tax years beginning after 1986, a fee-basis state or local government official can deduct the expenses incurred for services performed in that job in figuring adjusted gross income, rather than as a miscellaneous itemized deduction subject to the 2% limit. See the line 6 instructions for more details. You should file Form 1040X to amend any prior year income tax return affected by this retroactive change. However, you generally must file Form 1040X within 3 years after the date you filed

your original return or within 2 years after the date you paid the tax, whichever is later.

Purpose of Form

You may use Form 2106-EZ instead of Form 2106 if you meet all the requirements listed in Part I of this form.

Recordkeeping

You cannot deduct expenses for travel (including meals unless you used the standard meal allowance), entertainment, gifts, or use of a car or other listed property, unless you keep records to prove the time, place, business purpose, business relationship (for entertainment and gifts), and amounts of these expenses. Generally, you must also have receipts for all lodging expenses (regardless of the amount) and any other expense of \$75 or more.

For Paperwork Reduction Act Notice, see back of form.

Cat. No. 20604Q

Form **2106-EZ** (1997)

*See Attached Statement

IRS Section 265— Computation of expenses, allocable to tax-free ministerial income, that are nondeductible:

	TAXABLE	TAX-FREE	TOTAL
Salary as a minister	\$ 31,000		\$ 31,000
Parsonage allowance:			
Mortgage (\$800 × 12)		\$ 9,600	9,600
Utilities			
\$100 × 12 = \$ 1,200			
minus costs <u>960</u>		960	960
excess <u>\$ 240</u>	240		240
Gross income from weddings, baptisms, and honoraria	<u>4,000</u>		<u>4,000</u>
Ministerial income	<u>\$ 35,240</u>	<u>\$ 10,560</u>	<u>\$ 45,800</u>

Percentage of nondeductible expenses: $\$10,560 \div \$45,800 = 23\%$

Schedule C-EZ Deduction Computation

\$ 87	Marriage and family booklets
+ 156	Business use of car
<u>\$ 243</u>	Unadjusted Schedule C-EZ expenses
× 23%	
<u>\$ 56</u>	Nondeductible part of expenses
\$ 243	Unadjusted Schedule C-EZ expenses
– 56	Nondeductible part of expenses
<u>\$ 187</u>	Schedule C-EZ deductions (line 2)

Employee Business Expense Deduction Computation

\$ 884	Car expenses for church business
+ 219	Publications and booklets
<u>\$ 1,103</u>	Unadjusted employee business expenses (FORM 2106-EZ)
× 23%	
<u>\$ 254</u>	Nondeductible part of expenses
\$ 1,103	Unadjusted employee business expenses (FORM 2106-EZ)
– 254	Nondeductible part of expenses
<u>\$ 849</u>	Employee business expense deduction—FORM 2106-EZ, line 6

None of the other deductions claimed in the return are allocable to tax-free income.

**SCHEDULE SE
(Form 1040)**

Department of the Treasury
Internal Revenue Service

Self-Employment Tax

▶ See Instructions for Schedule SE (Form 1040).

▶ Attach to Form 1040.

OMB No. 1545-0074

1997

Attachment
Sequence No. **17**

Name of person with **self-employment** income (as shown on Form 1040)
John E. Michaels

Social security number of person
with **self-employment** income ▶

011 : 00 : 2222

Who Must File Schedule SE

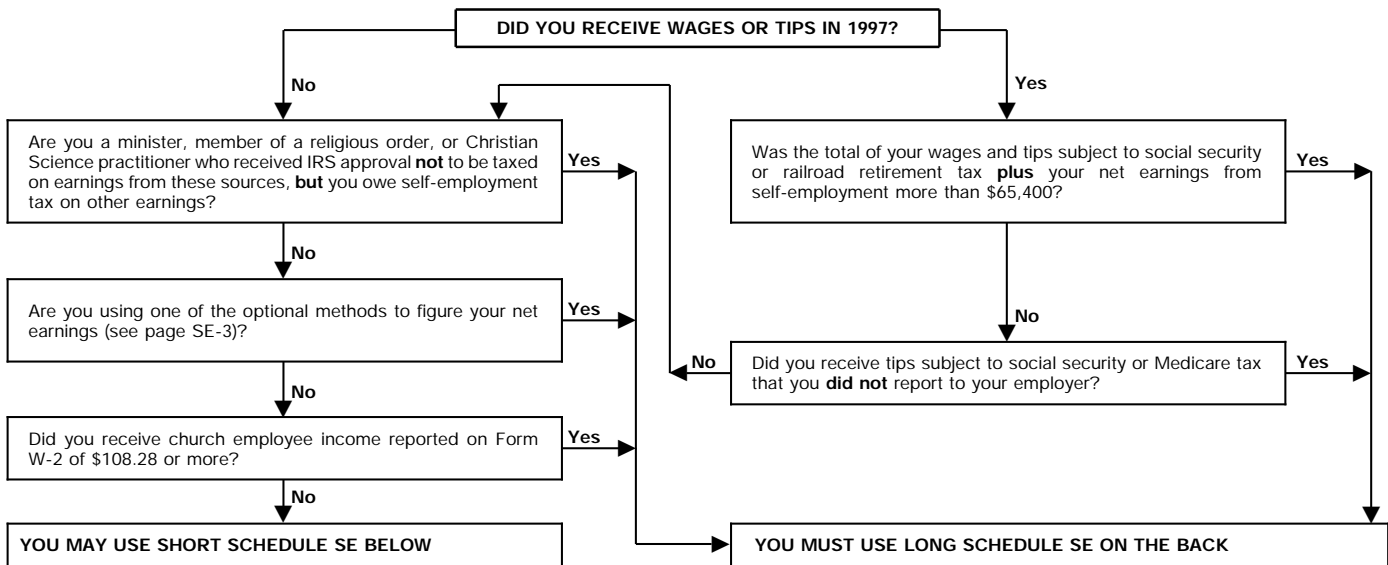
You must file Schedule SE if:

- You had net earnings from self-employment from **other than** church employee income (line 4 of Short Schedule SE or line 4c of Long Schedule SE) of \$400 or more, **OR**
- You had church employee income of \$108.28 or more. Income from services you performed as a minister or a member of a religious order **is not** church employee income. See page SE-1.

Note: Even if you had a loss or a small amount of income from self-employment, it may be to your benefit to file Schedule SE and use either "optional method" in Part II of Long Schedule SE. See page SE-3.

Exception. If your only self-employment income was from earnings as a minister, member of a religious order, or Christian Science practitioner **and** you filed Form 4361 and received IRS approval not to be taxed on those earnings, **do not** file Schedule SE. Instead, write "Exempt-Form 4361" on Form 1040, line 47.

May I Use Short Schedule SE or MUST I Use Long Schedule SE?



Section A—Short Schedule SE. Caution: Read above to see if you can use Short Schedule SE.

1	Net farm profit or (loss) from Schedule F, line 36, and farm partnerships, Schedule K-1 (Form 1065), line 15a	1		
2	Net profit or (loss) from Schedule C, line 31; Schedule C-EZ, line 3; and Schedule K-1 (Form 1065), line 15a (other than farming). Ministers and members of religious orders, see page SE-1 for amounts to report on this line. See page SE-2 for other income to report	2	44,454	*
3	Combine lines 1 and 2	3	44,454	
4	Net earnings from self-employment. Multiply line 3 by 92.35% (.9235). If less than \$400, do not file this schedule; you do not owe self-employment tax ▶	4	41,053	
5	Self-employment tax. If the amount on line 4 is: • \$65,400 or less, multiply line 4 by 15.3% (.153). Enter the result here and on Form 1040, line 47. • More than \$65,400, multiply line 4 by 2.9% (.029). Then, add \$8,109.60 to the result. Enter the total here and on Form 1040, line 47.	5	6,281	
6	Deduction for one-half of self-employment tax. Multiply line 5 by 50% (.5). Enter the result here and on Form 1040, line 26	6	3,141	

For Paperwork Reduction Act Notice, see Form 1040 instructions.

Cat. No. 11358Z

Schedule SE (Form 1040) 1997

* See Attached Statement

Attachment to Schedule SE (Form 1040)

Church wages		\$ 31,000
Parsonage allowance— Mortgage	\$ 9,600	
Utilities	<u>1,200</u>	10,800
Net operating profit from Schedule C-EZ		<u>3,813</u>
		\$ 45,613
Less:		
Schedule C-EZ expenses allocable to tax-exempt income	\$ 56	
Ministerial employee business expenses	<u>1,103</u>	<u>1,159</u>
Net Self-Employment Income Schedule SE, Section A, line 2		<u>\$ 44,454</u>

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